

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 187

August 17, 1956

STATUTE OF LIMITATIONS: OMISSION FROM GROSS INCOME IN EXCESS OF 25%

Syllabus:

The reporting of ordinary income as a capital gain does not constitute an omission from income under Section 18586.1 where there is a full disclosure of the sales price, costs, expenses and the amount of gain recognized.

During the years 1949 and 1950 taxpayers reported gains on the sale of certain real estate as capital gains. Taxpayers made a full disclosure on schedules attached to their returns as to the dates of acquisition and sale, the sales prices, costs, expenses, gain recognized and the amount to be taken into account.

Before the six year statute provided in Section 18586.1, but after the four year statute had expired, it was determined that the gains in question were ordinary income. Advice has been requested as to whether there was an omission from income within the meaning of Section 18586.1.

Three recent cases on this exact question have concluded that there is no omission from income under the 1939 Internal Revenue Code. See Davis v. Hightower, CA 5th Circuit, Feb. 29, 1956, 56-1 USTC 9313; Hommel et al v. Riddell, D.C. Southern California, March 1, 1956, 56-1 USTC 9385, and Lazarus v. U.S., U.S. Court of Claims, July 12, 1956, 56-2 USTC 9777. In all three cases the taxpayer reported a gain as capital gain but disclosed on his return, or schedules attached, the other requisite facts. The Internal Revenue Service later determined that the gains were ordinary income. In each case the court concluded that since a full disclosure had been made there was no omission from income.

This disclosure theory has now been incorporated in Section 6501(e)(i)(A)(ii) of the 1954 Internal Revenue Code. At least one court has indicated the 1954 amendment is but a clarification of existing law. Therefore, the Franchise Tax Board shall adopt the same rule in the application of Section 18586.1 to capital gains.